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OFFICE OF THE SECRETARY

DATE: 4 December 1992

TO: Donna Searcy

FROM: Robert Pepper *ml*

SUBJ: Roundtable on Capital Formation

Attached, for insertion in MM Docket No. 92-51, are excerpts from a tape transcription of a roundtable held by the Office of Plans and Policy (OPP) on capital formation issues. These excerpts include all of the discussions concerning security interest issues. The roundtable was held on Thursday, October 15, 1992 at the Washington Annenberg Program.

The discussants were Larry Golub of Wasserstein Parella Capital Markets; Marisa Harney of Chemical Bank; Beth Johnston of Continental Equity Capital Group; John Martin of Heller Financial; Tom Nelson of the Wakefield Group and Gary Ozanich of the Columbia Institute for Telecommunication Information. The FCC moderators were: Robert Pepper, Chief of OPP and Michael Wing, Special Assistant to the Chairman.

FCC staff observers included: James Gattuso, Deputy Chief, of OPP; Joanne Kumekawa, OPP; Michael Marcus, Field Operations Bureau; Charla Rath and Alexandra Wilson, Office of the Chairman; Robert Branson and Byron Marchant, Office of Commissioner Barrett; Michele Farquhar and John Hollar, Office of Commissioner Duggan; Peter Ross, Office of Commissioner Marshall; and Douglas Webbink and Jackie Chorney, Mass Media Bureau.

Attachment

FCC Transcript of Capital Formation Roundtable
- Security Interest Issues -
October 15, 1992

DISCUSSION I:

RESPONDENT: Within the debt discussion that we're having here, how important is the security interest availability, in your mind? We're talking about a lot of issues that are going to immediately impinge upon security interest concept, especially from a bank standpoint.

RESPONDENT: Well, I'm not the senior lender here, I think I'll defer to [unintelligible].

RESPONDENT: How important is it in the list of criteria? Again, management is one of the most critical issues, in terms of criteria. So, when you say that, is it important? Yes, it's important.

RESPONDENT: Is the absence of having it deemed deleterious to the availability of funds?

RESPONDENT: It has not been to date. There are structural ways that the banks can get comfort without that security interest, but it's been challenged and it's been an issue that has been battled around. Sometimes it gets more important. Sometimes it gets less important.

I think it depends on whether we're in the hey day of the eighties when people said, hey, who cares? Let's just give them the money. Whether you're at the end of a portfolio that looks like a disaster, and all of a sudden you're going to start thinking about your security.

RESPONDENT: If I could jump in here again --- I don't want to be Mr. Distinction, but you're talking about a situation where you already have a troubled company. I think it would make a very large difference, if you're talking about a situation that's at the edge, because there are parties who are thinking about putting money in (a deal) and are looking at the possibility of bankruptcy and what happens, how long does it take to get out of the situation?

Now, looking back a few years, from my experience, and looking at some of the work I've done, even in restructuring situations, on a going-in basis in a

healthy situation, if you think the odds of trouble are too big, you're not going to do it at all and there are different ways to structure a transaction to give a senior lender comfort other than security ...

MODERATOR: What are some of those things? What are the comfort mechanisms...

RESPONDENT: You could take a security interest in [unintelligible] the way to do it was to try to take a security interest in the ownership of the license holder. The problem that it causes, depending on which broadcast industry you're looking at, is that as a security -- taking collateral in the ownership structure does not protect you from any creditors that are actually at the level of the license holder. So for example, in a television station, if you got programming liabilities, those liabilities will rank before the security that's in the ownership.

So what a senior lenders would do in that situation is take security interest in the ownership and then limit, in a lot of different ways, numerical or various ways, the amount of debt that's permitted at the license holder level.

To some industries that matters; to some industries it doesn't. It doesn't really matter very much, I don't think, in radio. It matters more in television. It matters more in equipment-based technologies where you have a trade debt, and the ability to get that trade debt is going to be limited because the senior lenders are basically going to force the trade debt people to look at a different basket of assets for their [unintelligible]...

RESPONDENT: Basically, to clarify, so that everybody's out there in the same terminology. Trade debt would be the equivalent of short-term liabilities.

RESPONDENT: Yeah, and equipment manufacturers. If you're selling or paging, it's actually buying the pager and the equipment.

RESPONDENT: The real products.

RESPONDENT: My view on this is that we really do work in tandem, the [unintelligible] and senior debt is that the lack of security interest is often a reason to say why a deal is not getting done, which is sort of an easier letdown to some people that want to get a

deal done.

Really the issue in capital availability right now, in my view is, a lot of these industries you've seen, you're in a cycle and main prices were too high. Prices have to come down or operating income has to come up before there's going to be any transactions. It's not unlike real estate in that perspective. While that's happening, there's stagnation and it's frustrating and people need some reasons.

So I'm not saying that there is no effect, but you don't go into a deal because, if I'm a senior lender, I don't go into a deal because I can have a security interest in the license. You go in because you want to make money and that is not facilitated to make money.

The other thing I'd say to Larry's point about being on the edge, what we've seen is that certainly when things aren't on the edge, you're not getting a new set of equity and lenders in there. People are not coming in. You're talking about sticking with the same group, work through the problems and figure it out.

We're investors. We may be more involved in management than our lenders are, but we're not the managers and certainly, most of the banks we work with are not interested in taking over the company. They're interested in helping that company get to the point where it can repay its loan. So, I don't see it as the impeding factor here in capital to the communications industry.

RESPONDENT: Except that we're dealing with a group of people -- again, remember my comment about having to bother with licenses and where we're getting the senior debt from, it is almost impossible to explain to a foreign credit committee what the status is of the security interest in a license and why you can't have it, why it's okay and here we're taking stock in the company instead. In a lot of cases I would say that it would be a lot easier to raise a lot of money faster if you could make that distinction to people who don't understand. That, still again, depends very much on what size the transaction is, what kind of a group ...

RESPONDENT: Couldn't you then get into foreign ownership troubles?

RESPONDENT: Yeah.

RESPONDENT: Oh, no no, I'm not suggesting ...

RESPONDENT: Than if it were foreign banks?

RESPONDENT: I'm not suggesting that -- if you're a security interest, would that actually violate the ...

MODERATOR: That's a good question.

RESPONDENT: They're writing the rules. They can say that it doesn't.

RESPONDENT: If that's true, then we would all be in big trouble and we really don't want it because then you can't have Canadian [unintelligible] Imperial, all these ... if you're going to say that the foreign banks can't have the security interest, then God, don't do that! You cut off all the money.

RESPONDENT: That wouldn't work. That goes to ownership and control, but the fact is that you exercise --- if you exercise on your security interest, and therefore become [unintelligible]...you step into the ownership shoes, it would depend upon how that's exercised. The question is whether you could hold that or whether or not you'd have an interest that you'd then have to sell to a domestic buyer.

RESPONDENT: There's a middle ground I think, though. Everyone is obviously concerned about control of ownership, but banks don't want it. The banks just want the money. They put money in; they want it back. There's a middle ground to say that, we're concerned about other lenders who might have a priority claim, if there was a way of saying, okay, you don't get control over the license, but you get first dibs on the proceeds. That might get around some of those issues. I'm not saying it's got to look just the way it looks today.

RESPONDENT: But you've got that anyway.

RESPONDENT: No, you don't necessarily.

RESPONDENT: See, I would have the point of view that even with the security interest, you don't have it because in a bankruptcy situation, you're going to get primed anyway.

RESPONDENT: But that's true of any security interest though.

RESPONDENT: But I think it's particularly true in situations where the intangible values are subject to

manipulation by both sides in a litigation process.

RESPONDENT: Oh sure.

RESPONDENT: We're dealing with an asset that's got completely variable values.

RESPONDENT: You mentioned bankruptcy briefly. I've had some number of foreign banks who might go to syndicate something, [unintelligible] ... the U.S. debtor-favored bankruptcy system. Also, very typical ...

MODERATOR: But not just in communications, but general across the board.

RESPONDENT: But trying to get them to understand that and then understand, on top of that, an uncertain regulatory environment, in terms of what happens with this license, what do you do with it. It's complicated.

MODERATOR: It is because if you look at an ordinary operating company, or not ordinary, but one that's outside of the communications industry, any lender can look at hard assets, receivables and inventory and fixed assets. An immediate property, a television station, for example, the license is the primary asset of the business. So looking at those types of companies, and the assets that they employed, makes a big difference.

RESPONDENT: There's the school of thought that holds that, if the lender has a security interest, or does not have a security interest, will take the latter first. If a lender does not have a security interest, that they may be more inclined to cooperate in a negative environment. In other words, if it's trending downward, because [unintelligible]... things on a pro rata basis in terms of distribution of any remaining assets, as opposed to the other school of thought, they say, well, which I would look at from a business background, if I have a security interest, I know that then I am, by definition, secured, but I'm probably, in that context, more motivated to help work it out because I already know that I'm protected as a security interest.

Whereas, if I'm on a pro rata basis, and I'm the senior lender, in terms of a just amount of money that is owed to me, if I see a downward slope, it then behooves me, in theory, to act far quicker to maybe move that entity towards dissolution or recapturing the remaining assets so that my percentage loss is closer to being whole than if I let it continue to slide downward. So in sum, my

question is, is it perceived in a negative situation that security interest provides motivation to continue to help or not?

RESPONDENT: I worked on numerous credit committees in bankruptcies and, as an unsecured lender, I'm always looking up at the banks. It's very difficult to really generalize. There's a chemistry in every workout. I've been in situations where supposedly, some lenders were secured, but they always take a haircut. It's never been my experience -- I don't know if anybody else has had any way, everybody doesn't contribute somewhat. The security interest -- I just think it's difficult to be quite so clear cut about it, to also get back to this whole secured interest. The organization of these corporations so often are complicated with lending different levels that really, we're speaking in sort of a theoretical sense. When you really are in a situation where things are blown up, it's amazing how much debt you can find if there is operating levels and also, trying to determine just what's available -- once again, speaking as a secured lender. I think that there's no simple yes or no answer to that and it really is relative to each situation.

RESPONDENT: The variable value of this quote, unquote asset, I don't think anyone secured, using the whole media industry as a context for this, anyone secured is very comfortable in saying, well, I'm in a good position. This thing's going downhill, but it doesn't matter, I'm secured because the values are cash, operating cash flow driven. So, if this thing goes downhill, the security interest could just become moot at some point. So I completely agree. Every deal will have to be worked out as different.

RESPONDENT: But hasn't it changed the last 5 years? Was there an assumption 5 years ago and before, earlier, that it would never go down; it would always go up -- the proverbial bubble?

RESPONDENT: There's a sense of stick value ... which I think is being tested, I mean, certainly has been tested. If I were to think about that, that does provide some sort of a floor that says that the license is worth my security in the license -- should be at least worth stick value, whatever that is.

RESPONDENT: Well, but if stick value is worth 10 million dollars and you're lending 100 million, you got a problem.

MODERATOR: But I think Gary made an important point, which I tend to agree with, that in real life, leaving aside the marketing issue, which I'm familiar with, and if it helps you sell some, it's real important, but in real life, after the fact, having a security interest or not having a security interest is a minor chip in a complicated negotiation. It's indeterminable value in a circumstance you've already been wrong about a number of things. So at the margins it might make a difference, but by the time you're at the margins, you're already in deep trouble.

RESPONDENT: Yes, in the end I'm not sure you could ever really say it makes that big a difference because you're going to have a security interest in all the other assets. You're going to have done your structural subordination and it's going to be one chip in very big, complicated puzzle.

RESPONDENT: That's right. As to the point of how important is it, well there are so many other criteria that so important. Is it important? Oh, yeah. A security interest is always important, but is it the most important thing in the deal?

MODERATOR: It's certainly on the list.

You let her get it. She will take it every time because it's always better to have than to not have additional security interest.

RESPONDENT: So what do you ask for now? You can't have a security interest today. What are the alternative ...

RESPONDENT: A pledge of the ownership interest of the license.

MODERATOR: You get that anyway.

RESPONDENT: Yeah.

MODERATOR: You got security because you're also going to get that.

RESPONDENT: How important are exit strategies, or do you not want to think about those things going in? Were you worrying about those in the eighties?

RESPONDENT: No. No. You were basically looking at -- if you hit a trouble situation -- well, let me speak for the industry, not for myself. I think the market place perceived that the assets were readily liquid

and that you could, in effect, sell off particular assets. I think it's not just a question of a cash flow shortfall or assets devaluing. It's a question of repaying the principal or the zero coupon bond that turned cash pay or pic maturities. There's a cynical school that states that Wall Street firms generate fees in distress situations. They generate fees in situations where securities are issued. I'm just saying that the due diligence really rests, not only with the issuer, but also rests with the buyer and I'm really just representing the sell side. So I think we always felt there would be some degree of ongoing transactions in these systems. George Gillette, when he bought [unintelligible] TV -- my numbers indicated he paid sixteen and one-half times cash flow for those tv stations, which is outrageous. I don't even know where the market is now. On eight and [unintelligible]?

MODERATOR: Significantly less.

RESPONDENT: Significantly less. We all knew the deal shouldn't have been done, but the deal was done basically through Drexel related party transactions, but ...

DISCUSSION II:

RESPONDENT: We're going to come to that next. That's the next set of questions on new business. While you're contemplating the other questions, I've got one other one that I'd like to make sure we give various succinct answers to before we move on to other topics. And that is again, back to security interests.

You're sitting here with people from the FCC and desiring or wondering of what can be done to facilitate capital formation. Is further contemplation on security interest a worthy pursuit to facilitate capital formation, from your perspective or not? Does it facilitate or is it not facilitated? There's no sharing of answers.

RESPONDENT: We can have a joint answer.

RESPONDENT: Michelle has a ...

RESPONDENT: I have a question too. ... HDTV ... How would you be expected to raise money to finance ... cost of that?

RESPONDENT: Actually, I was thinking on terms of the next ground, which has to do with the next step, which are the new industries and technologies reinvestment for the ...

MODERATOR: Think ing hard about your question, but I don't have answers to your question, but one of the ways I think about it is ...

RESPONDENT: [Unintelligible]... had no answer, but ...

RESPONDENT: I wonder if you asked a lender, would you rather have an extra half a point fees or security interest in the license, which the lender would prefer and every case is different? It sounds so mercenary.

RESPONDENT: Is there a risk return trade-off? How great is the risk of not having a license and how much is it worth in terms of return? To date, not having full security interest in a license has not stopped lenders from lending to broadcasters. Do I have a good sense of whether, as we have to expand the places that we go today, whether that's going to pose more of a problem or less of a problem in future, I don't know.

MODERATOR: Is there a difference between radio and television, as you look forward? Talking about broadcasting, it seems to me there may be differences.

RESPONDENT: I think the difference isn't so much between radio and television as much as structurally. If the problem that we talked about before, in terms of taking a security interest to protect the mother creditors, if you take that simple comment, it's more likely that television has more creditors, other types of creditors than radio. It's also true that equipment based technologies have more creditors than radio. Radio just inherently tends to have less other creditors.

RESPONDENT: So the security just may be less of a problem?

RESPONDENT: It may be less of a problem in radio. In general, it has not stopped.

MODERATOR: To what extent have the changes that have been proposed, maybe they have been adopted by the Controller of the Currency on defining how the leverage of transactions and therefore, whether capital is available, not available made a difference in terms of capital availability here in the broadcasting market?

RESPONDENT: They make a huge amount of difference to people. HLT definitions do not actually dictate. They're disclosure issues; they're not actually dictating. So I think different institutions have very different ways that they deal with that. Some people dealt with it very opportunistically. They said, well, we've got -- we as an institution -- and we're not speaking for [unintelligible] we, as an institution have a much more secure feeling about our capital base. We're going to opportunistically use this to shut out more people who have more problems and we'll do some of this and we'll add to our portfolio.

So it's been a perception issue more than anything else. I think that what it did was it focused some people more on fundamentals and the fundamentals are ultimately what count, not what you call something. I think the whole HLT thing, I think accomplished what it needed to accomplish and it's over. But what ultimately is important, from a senior lender at the bank, we're talking commercial banks at this point, is that we are driven to a risk based return model now. We have to look at the risk of the transaction and various banks categorize them different ways internally. The nature of that risk is going to dictate the return that that bank needs to earn. I was thinking of this in terms of your first question, which is how do you decide what kind of return you're going to earn? It's a perception of risk and I'm a smart broadcaster lender so I can list a number of reasons why I think something is or isn't risky. It doesn't matter what I think. It matters what regulators think and another body, who is less experienced, who is looking at that transaction, thinks about its risks. So all these different risks that we talk about, which we refer to around the bank, as nails in the coffin. Do you think the security interest is really going to make a difference. Well, no, but it really helps if you really need to prove a case to somebody about the risk categorization of the transaction. And that's going to dictate the kind of return that the bank needs to earn. Does that help and do you add a half a point on something for giving up the security interest? I don't know. Transactions are too different to be able to make that kind of a decision.

RESPONDENT: Anything else on security interest?

RESPONDENT: I would say relative to other regulations that the FCC adopts, could adopt, has adopted, it's very small.

DISCUSSION III:

- RESPONDENT: ... taking a budgeted ownership. What other mechanisms? Again, I [unintelligible] this was basically a housekeeping type item to close off some of the notes that had been taken before.
- RESPONDENT: There's nothing else to get you in the same ...
- RESPONDENT: Personal guarantees, depending on the size of the transaction. I mean, in the world that you're playing in ...
- MODERATOR: You had also mentioned comments eliminating the ...
- RESPONDENT: Oh yeah. I think what you're trying to get at is some kind of certainty of value too. So, I mean, how much -- if you take a security interest -- how can you at least protect yourself? You've limited the amount of other creditors. That was one thing we said is important. Well, how do you decide how much to limit the other creditors to? You have to have some kind of an idea of what you hope value is, and then the rest of the transaction is just structured that value as much as possible for the lenders that are left, which are hopefully, you and some limited amount of other creditors. That's financial covenants to maintain certain cash flow numbers. If cash flow multiples are measured in value, cash flow multiples are going to be a proxy for loans evaluation.
- RESPONDENT: Then any violations are variations from that, then put it into potential default.
- RESPONDENT: Put it into default, stops the advancing of additional funds and everybody comes to the table and decides what to do.
- MODERATOR: Programmers, by the way, are somewhat panicked, or not panicked, but they are very concerned about changes in existing relationships. I'm sure that you heard from them ...
- RESPONDENT: That they are. For the flip side.
- MODERATOR: Tom, out of deference to you, there was basically, in the other panelists, if I misstate this, please correct me, but there was basically, in a summation type of dialogue, regarding security interests,

there seemed to be a consensus that, if there's an opportunity to get the security interests, that's great, thank you very much. It was basically, succinctly summarized as not being essential and was presented as not being an impediment at the present time, for additional investment capital. Do you concur with that?

RESPONDENT: I would agree.

MODERATOR: Okay. To all those assembled, are there any other questions regarding security interest before ...

RESPONDENT: I'd just like to ask one question. How could your view change, given the controversy in the bankruptcy courts about what your security interests and the other tangible assets. There's been some quotations that are [unintelligible], but you were not able to recognize the value of the license, the sales, the proceeds. The fact that ... investment ...

RESPONDENT: Are we back to the question of whether or not we're making an investment that we think is going ... I think ultimately we have to get back to -- we're getting into some very very technical issues in bankruptcy that, believe me, we don't like to think about going in. We'd like to think, and we're not in the hey days of ... that continually go up, but we'd like to believe that the criteria for how we structure a deal isn't the absolutely concrete structure that gets us out of bankruptcy.

We hope that it's never going to put us in bankruptcy to begin with. So I would not say that the court, the varying decisions in the courts, have really affected it all that much. I think again, I can't really speak for how smaller transactions get structured. Transactions are perhaps, have more risks because they're single-market or few-market transactions. I think the larger transactions, quite frankly, have moved further and further away from really focusing on security interests. In really, the larger group transactions, whether you want to turn to how it affects the smaller broadcaster, that's a really tough question and I don't have a good answer to that.

MODERATOR: I think that one thing that the banker, some of the findings in the bankruptcy courts, have caused you to do is, it just adds an additional element of risk in your up-front investment decision. So you have to do ...

RESPONDENT: The deal has to be that much better.

MODERATOR: It does. It's just one more set of risks that you have to evaluate going in, decide whether the risk reward relationship is ...

RESPONDENT: But the reality that we found is that, cash flows worked out grow 8% compounded every year, but maybe by the year 2000 ... more significant.

END OF SECURITY INTEREST DISCUSSIONS